



OFFICE OF
INSURANCE COMMISSIONER

In the Matter of)	No. G05-40
)	
The Financial Examination of)	FINDINGS, CONCLUSIONS,
FARMERS INSURANCE COMPANY)	AND ORDER ADOPTING REPORT
OF WASHINGTON)	OF
)	FINANCIAL EXAMINATION
A Domestic Insurer.		

BACKGROUND

An examination of the financial condition of **FARMERS INSURANCE COMPANY OF WASHINGTON** (the Company) as of December 31, 2003, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of authority as a stock insurer. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and comments and recommendations was transmitted to the Company for its comments on June 1, 2005. The Company's response to the report is attached to this order only for the purpose of providing convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners work papers, and submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 22 of the report.

FARMERS INSURANCE COMPANY OF WASHINGTON

Order Adopting Examination Report
June 30, 2005
Mailing Address: P.O. Box 40255 • Olympia, WA 98504-0255
Street Address: 5000 Capitol Blvd. • Tumwater, WA 98501



CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **FARMERS INSURANCE COMPANY OF WASHINGTON** and to order the Company to take the actions described in the Instructions section of the report. The Commissioner acknowledges that the Company may have implemented the Instructions prior to the date of this order. The Instructions in the report are an appropriate response to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

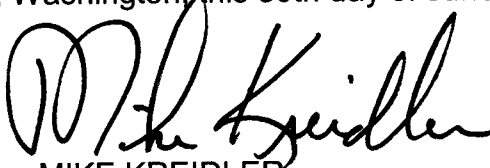
The Company is ordered as follows, these being the Instructions contained in the examination report on pages 1-6.

1. The Company is ordered to comply with RCW 48.12.090(1) by making a reasonable provision for all unpaid loss and loss expense obligations in the future. Instruction 1, Examination Report, page 2.
2. The Company is ordered to comply with RCW 48.05.073 by filing its financial statements in accordance with the NAIC Accounting Practices and Procedures Manual (AP&P). Instruction 2, Examination Report, page 3.
3. The Company is ordered to comply with RCW 48.31B.025(2)(c)(v) and file an amended annual registration statement which adequately discloses the terms and conditions of the cost allocation and administrative agreements. Instruction 3, Examination Report, page 4.
4. The Company is ordered to comply with RCW 48.13.450 and correct all of the deficiencies and execute a revised or amended Agreement and Rider with JPMorgan Chase Bank and a revised or amended agreement with BNY. The Company is further ordered to comply with RCW 48.05.250 by filing a true statement of its financial condition, transactions, and affairs. The Company is further ordered to comply with WAC 284-07-050(2), requiring the Company to file its NAIC Annual Statements in accordance with the NAIC Annual Statement Instructions. Adherence to the FCEH is one of the requirements of the NAIC Annual Statement Instructions. Instruction 4, Examination Report, page 4.

5. The Company is ordered to comply with RCW 48.05.280 and isolate its cash, identify its outstanding claims checks and collected premiums, and properly reflect the cash associated with these amounts in its ledger. Instruction 5, Examination Report, page 5.
6. The Company is ordered to comply with RCW 48.05.073, RCW48.05.250, and WAC 284-07-050(2) in filing its NAIC Annual Statement in accordance with the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions. Instruction 6, Examination Report, page 5.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Tumwater, Washington, this 30th day of June, 2005.

A handwritten signature in black ink, appearing to read "Mike Kreidler", is written over the printed name.

MIKE KREIDLER
Insurance Commissioner



FARMERS

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May 2, 2005

Mr. James T. Odiorne, CPA, JD
Deputy Insurance Commissioner
Company Supervision Division
Office of the Insurance Commissioner
State of Washington
5000 Capitol Blvd,
Tumwater, WA 98501210

RE: Farmers Insurance Company of Washington (NAIC #21644)
Financial Examination as of December 31, 2003

Mr. Odiorne,

We have received and reviewed the examination report and management letter for the Farmers Insurance Company of Washington as of December 31, 2003 and wish to compliment the Department and the Examiner on their thoroughness and cooperation. We acknowledge that the final report contains certain recommendations and comments. We have carefully reviewed the final report and respectfully submit the following responses to your findings.

Issue

Loss & Loss Adjustment Expenses (LAE) – An adjustment for \$17,835,000 is included in the financial statements of this examination report. The Company is instructed to comply with RCW by making a reasonable provision for all unpaid loss and loss expense obligations in the future.

Response

At the time of our 2003 annual statement filing, the company felt that reserves levels were adequate as verified by testing done by our outside auditors. We later determined that the beginning of several claims initiatives and changes in claims procedures had a material impact on Auto Liability loss development patterns. Significant changes included implementation of CRN (Claims Restoration Network) providing new technology tools for our claims adjusters and allowing for paperless claims file handling, creation of the HelpPoint call center to centralize incoming claims reports, and opening Centers of Excellence for specialized claims handling. These initiatives promised (and delivered) improved claims handling, but in the short term, disruption with these new systems and procedures caused changes to our payment and case reserving patterns.

During 2004, the actuaries found in hindsight that loss development projections based on historical patterns and used to set reserve levels were inadequate. Reserves were strengthened in 2004.

Recommendation - In view of the fact that the reserves were reasonable and were based on estimates and historical data available at the time statements were prepared, we recommend that the reference to the comment on page 2, paragraph 1 on non-compliance be removed from the report.

The company's position that they did not know when the statement was filed appears to be true. See below extracted from the CA MAC report. In other words they were not officially on notice that there was a reserve problem until June 1, 2004. JE

Background:

This was initially a triennial examination with an as-of date of 12/31/2002. Draft 12/31/2002 examination reports (along with 30-day letters) for the eight California-domestic Farmers companies were provided to the Company on **June 1, 2004**. These draft reports utilized American Actuarial Consulting Group, LLC (AACG) determined preliminary loss/lae reserve levels which depicted very significant reserve deficiencies. Management of these companies has taken strong exception to the level of losses used in the 2002 exam reports, specifically for P.P. Auto Liability and Homeowners. They don't materially disagree with our findings on the other lines of business that AACG has reviewed. The reserves in contention for the 2002 exam reports are primarily the Auto Liability and Homeowners reserves "in amounts in excess of that already subsequently *strengthened* by Farmers itself".

1) Exam rolled forward:

On June 30, 2004 the California DOI formally notified Farmers management that the examination will be rolled-forward to an as of date of 12/31/2003, and that the aforementioned preliminary California draft exam reports as of 12/31/2002 will *not* be filed.

Issue

Contingent Litigation – An adjustment in the amount of \$3,936,000 is included in the financial statements of this examination report. The Company is instructed to comply with Washington the OIC report by filing a true statement of its financial condition, transactions, and affairs by filing its financial statements in accordance with the AP&P.

Response

At the time of the annual statement filing, the outcome of the claims representative overtime cases was uncertain and the financial impact was neither probable nor measurable. In May 2004, when the appeal was denied, FIE began settling with the parties and an accrual was established for the full liability in 2004.

Recommendation - Given the fact the Company believed it had no liability at the end of 2003, we ask that the first and second paragraphs at the top of page 3 on non-compliance be removed from the report.

Original jury verdict July 2001 and appealed in 2001. There was a \$30 million liability accrued at 12/31/2003 for the group for the Bell case. It was included in the pool and allocated to Farmers of Wa. It appears that was their best estimate at that time. JE

Issue

Management Service Agreement with Affiliate – The Company does not have a written management services agreement between FICOWA, FGI, and FIE. The Company is instructed to file an amended annual registration statement which adequately discloses the terms and conditions of the cost allocation and administrative agreements.

The report also states that the Company “failed to disclose intercompany cost allocation and administrative service agreements between FICOWA and its affiliates since initially required to in 1971...”

Response

The Company does not have its own employees, but instead is party to a reinsurance agreement with Farmers Insurance Exchange (FIE), as filed with the State of Washington in 1970. FIE assumes 100% of the Company’s direct business. Although we believe that expenses related to management services and related fees are anticipated and covered under the broader “due to the reinsurer category” contained in the 1970 reinsurance agreement, which reads that FIE is responsible for all losses, LAE, and operating expenses of the intercompany reinsurance pooling agreement of which FIE is the lead participant, Management filed supplemental documents with the Washington Office of the Insurance Commissioner to more clearly define FIE’s responsibilities with the Company.

Also, the report section that states the Company has failed to disclose applicable agreements since 1970 can be interpreted to mean that the company has operated without filing for or obtaining approval under this statute in the past. As a practical matter, the Company filed for and received approval for the reinsurance agreement in 1970 under the existing Washington regulations, which has sufficed as fulfilling this requirement for decades. The agreements we are now filing more clearly define FIE’s and FICOWA’s roles and responsibilities under the existing 1970 reinsurance agreement.

Recommendation - We recommend that the report be updated to include the following disclosure:

“Prior to the issuance of this report, the Company submitted to the Washington Office of the Insurance Commissioner (OIC) a management services agreement between the Company and FIE, the provider of record for management services. This agreement broadly encompasses management services, claims adjustment services, and investment advisory services. Approval from the OIC is pending.”

This is probably OK JE

Additionally, we recommend that the reference regarding failure to file a Service agreement since 1971 be removed from the report.

This wording came from Harmers New World Life Do you want to drop the year reference? It does not appear to be a significant compromise. JE

Issue

Custodial Agreement – The Company’s undisclosed custodial agreement with BNY did not contain all provisions required by FCEH. The Company is instructed to correct all of the deficiencies and execute a revised or amended agreement with JPMorgan Chase Bank and a revised or amended agreement with BNY.

Response

Agree, and will amend the agreement with JPMorgan.
OK

Issue

Commingling Cash – The Company’s general ledger reported premium deposit balances totaling approximately \$2,413,200,000, and claims check liabilities totaling \$3,313,729,599, with equivalent offsetting balances. The premium and loss amounts are not meaningful because the Company commingles these balances with its affiliates. The Company is instructed to isolate its cash, identify its outstanding claims checks and collected premiums, and properly reflects the cash associated with these amounts in its ledger.

Response

Some of our premium collections and claims payments are handled through centralized programs. As cash is collected, corresponding credits/debits are applied to each policyholder’s account and company in the billing system and can also be identified at the state and line of business level. All amounts in question, however, belong solely to FICOWA and are reflected correctly on a net basis. All transactions with affiliates are settled monthly. However, we have noted the issues above, and will continue to review our cash collection programs to ensure that balances in the various accounts are accurate and properly reflect amounts due to or from affiliates, including FICOWA.

Report OK as IS. They are commingling cash and cash balances relating to FICOWA are not being properly reported on their books and records. JE

Issue

a) Statement Errors and Misclassifications - The 2003 Annual Statement instructions require that the details pertaining to the reporting entity shall be disclosed under Notes to Financial Statements. In note No. 12, “Retirement Plans, Deferred Compensation, Postemployment Benefits and Compensated Absences and Other Postretirement Benefit Plans,” the Company disclosed the aggregate ~~obligation~~ amount recognized for all participating Farmers companies of \$39.3 million for 2003. However, it failed to disclose the amount recognized ~~allocated liability amounts~~ attributable to FICOWA. The Company’s 2003 Notes to Financial Statements No. 12 does not meet the detail disclosure requirements of the 2003 NAIC Annual Statement

Instructions. Therefore, the Company is not in compliance with WAC 284-07-050(2) and RCW 48.05.250.

Response

The postretirement benefits obligation disclosed in the notes to the financial statements was for benefits of claims employees of FIE. However, a portion of this expense is assigned to FICOWA as a pooled participant. In 2003, we disclosed the Company's share of the post retirement benefit obligation, and not those relating to the net amount recognized at year-end, since it primarily represents the balance for the reconciliation of funded status.

Recommendation - We ask that this issue be removed from the examination report.

The Company did not disclose its portion of the "Net amount recognized at end of year" as required by the annual statement instructions. Wording above revised to be more specific. JE

Issue

b) Note 21 of the Notes to Financial Statement, page 14.9, states: "Restatement of Beginning Balances. Certain changes were made in 2002, which impacted the assignment of direct loss and loss adjustment expense reserves by company, state, and line of business. A new method was employed to assign IBNR loss and loss reserves by state for Farmers' Property & Casualty (P&C) Companies; auto, fire, and commercial lines of business. The beginning balances for direct unpaid losses and loss adjustment expenses were restated on the "Exhibit of Premiums and Losses (Statutory Page 14)" to be consistent with the change. For further information regarding the restatement, please contact (the) Director of P&C Accounting..." The Company did not include the disclosures required by SSAP 3. RCW 48.05.073 and WAC 284-07-050(2) require the Company to file its financial statements in accordance with the AP&P manual.

Response

The restated beginning loss and loss adjustment expenses on the 2003 statement resulted from a change in accounting estimates/change in loss reserve estimates and was handled on a prospective basis. As stated previously on a prior correspondence on this issue, the only reason for restating the prior year's results was to provide comparability of results across the two years involved and this information was fully disclosed in note 21C of the 2003 financial statement. However, we will review this request for perspective to ensure we are in compliance with applicable reporting requirements.

All required disclosures were not made report ok as is JE

Issue

c) Description of management contracts and cost-sharing arrangements - The 2003 NAIC Annual Statement instructions require that the description of management contracts and cost-sharing arrangement shall be disclosed under item F of Notes to Financial Statements No. 10, 'Information Concerning Parent, Subsidiaries and Affiliates.' The Company's 2003 disclosure was limited to the statement of its GAAP compliance with existing contracts. However, it failed to include a description of the Company's current cost allocation arrangement from the inter-company pooling arrangement. To be specific, the NAIC Annual Statement Instructions require

Response

Agree, and will take corrective action to ensure accuracy in the future.
Report OK as is JE

Issue

e) Recording of Investment Transactions - The Company did not report a preferred stock disposal with a trade date of December 16, 2003 until January 2004, when the transaction settled. This is a violation of RCW 48.05.073, which requires an insurer to file a true copy of its financial statements, transactions, and affairs, and with WAC 284-07-050(2) which requires the Company to adhere to the NAIC AP&P manuals.

Response

As indicated in prior correspondence we had on this issue, we've researched the matter further and have concluded that we properly reported the disposal of the preferred stock in question. This is a sinking fund with a trade date of 1/15/04 per Bloomberg. The date JP Morgan reported as their trade date is the DTC notification date to JP Morgan, which is not a trade date since there have been no rights and obligation changes or exchanges. The sinking fund schedule on Bloomberg shows the January 2004 date.

Recommendation - Since this disposal was reported in December 2003, we recommend that this section be removed from the final report.

We have done additional research and agree with their position that the December date is not an appropriate "Trade Date" we have asked for confirmation from Tim Hayes. JE

In addition to the Department's findings, we noted the following during our review of the draft report:

a) Page 13 (under Reinsurance)

Third paragraph - The report states that the 10% Quota Share and 20% Auto Quota share agreements limit the reinsurers' share of ceded liability to "about 75%." Unlike the ratio quoted for APD, the ratio specified in the report for these two quota share treaties does not include expenses. We recommend that the fourth sentence on page 13, third paragraph, be revised to read, "These contracts, which limit the reinsurers' share of the ceded liability to 95% of gross reinsurance premiums for the APD and to about 112.5% for the other two contracts...".

OK revision approved by John G

Kindly review the responses above and incorporate into the revised report. In addition, we would like to review the updated draft report once all the changes have been made prior to filing.

As always, we appreciate your attention to this matter, and look forward to hearing from you. Please advise if you have any questions.

Sincerely,

John McCoy
Treasurer
Farmers Insurance Company of Washington

cc: R. Myhan, D. Hohl, B. Katz, Jerry Epler, (WAOIC), File

JH